

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of )

Policy and Rules Concerning the )  
Interstate, Interexchange Marketplace )

Implementation of Section 254(g) of the )  
Communications Act of 1934, as amended )

1998 Biennial Regulatory Review -- )  
Review of Customer Premises Equipment )  
and Enhanced Services Unbundling Rules )  
in the Interexchange, Exchange Access, )  
and Local Exchange Markets )

CC Docket No. 96-61

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

CC Docket No. 98-183

**REPLY COMMENTS OF AT&T CORP.**

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No. of Copies rec'd 0+6  
List A B C D E

AT&T Corp.

December 23, 1998

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## SUMMARY

As the comments confirm, non-dominant interexchange carrier service providers should be allowed to bundle customer premises equipment and enhanced services with telecommunications services. The prohibition on bundling, which was designed to protect the developing CPE and enhanced services markets when telecommunications service providers had market power in basic common carrier services, is not necessary in today's current competitive environment. The markets for interexchange services, CPE and enhanced services are each competitive so that the restrictions on bundling no longer serve any useful purpose when applied to non-dominant interexchange carriers. In fact, elimination of the prohibition will help spur the creation of innovative offers that cannot be offered today. Therefore, the Commission should adopt its tentative conclusion that where markets are competitive it is unlikely that non-dominant interexchange carriers could engage in anticompetitive conduct that served as the basis for the bundling restriction.

The comments also confirm that elimination of the bundling prohibition will have no effect on non-dominant carriers' network disclosure obligation under the "all-carrier" rule. However, the Commission should take this opportunity to permit carriers to use proprietary interfaces, so long as the carrier also discloses a publicly available interface that provides users the same features and functionalities as the proprietary interface.

With the exception of the incumbent local exchange carriers ("ILECs"), the commenters strongly urge the Commission not to permit dominant ILECs to bundle either CPE or interstate enhanced services with local services. The concerns that resulted in the *Computer II*

restrictions on bundling still apply to the dominant LECs, because of their enormous market power in local exchange services. Consequently, if the restrictions were eliminated, the ILECs would have the means and incentive to harm emerging competition in the local service market. Therefore, the Commission should not eliminate the bundling restrictions for the dominant ILECs.

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**REPLY COMMENTS OF AT&T CORP.**

Pursuant to Section 1.415 of the Commission's Rules, and the Commission's Further Notice of Proposed Rulemaking, FCC 98-258, released October 9, 1998 ("FNPRM"), AT&T Corp. ("AT&T") submits these Reply Comments on the Commission's proposals to eliminate the restrictions on bundling of telecommunications services with customer premises equipment ("CPE") and with enhanced services.

The commenters are almost unanimous that the Commission should remove the restrictions on bundling of non-dominant interexchange services with CPE and enhanced services. Indeed, the few parties that opposed such removal in 1996 have not filed any opposition to the Commission's tentative conclusion that non-dominant interexchange carriers should be permitted to bundle IXC services with CPE and enhanced services. The commenters recognize that the

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interexchange, CPE, and enhanced services markets are all fully competitive, and thus there is no danger that bundling could harm competition. To the contrary, bundling will serve the public interest by allowing carriers to offer more efficiently priced packages that more effectively cater to their customers' needs.

The commenters are similarly in agreement -- with the exception of the incumbent local exchange carriers ("ILECs") -- that the Commission should *not* permit dominant LECs to bundle local service with CPE or interstate enhanced services. The ILECs, as dominant carriers, retain overwhelming market power in the local exchange market and can leverage that market power into these other markets if bundling is permitted. As shown below, the comments demonstrate that the ILECs' arguments to the contrary are baseless.

**I. THE COMMENTERS OVERWHELMINGLY AGREE THAT THE COMMISSION SHOULD PERMIT CARRIERS TO BUNDLE INTEREXCHANGE SERVICES WITH CPE OR ENHANCED SERVICES.**

Virtually every commenter agrees that the Commission should now remove the restrictions on bundling interexchange services with CPE and enhanced services.<sup>1</sup> Indeed, the few parties that previously opposed the removal of such restrictions in 1996,<sup>2</sup> such as IDCMA, *did not*

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<sup>1</sup> MCI at 1; Sprint at 2; Network Plus at 3, 14-15; BellSouth at 1-2; CompTel at 4; ENTUA at 2-3; and KMC at 2. *See* Attachment A for a list of commenters in this proceeding.

<sup>2</sup> *Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Communications Act of 1934, as amended*, CC Docket No. 96-61, Notice of Proposed Rulemaking, 11 FCC Rcd. 7141 (1996).

*even file comments.* As of today, no one even advances the arguments against removing the restrictions that IDCMA and others previously put forward, and on which the Commission sought comment. *See* FNPRM, ¶¶ 13-20. Support for removing the restrictions now comes from all quarters, including long-distance carriers, local carriers, enhanced service providers, customer groups, and even CPE manufacturers (*see* CEMA at 2).

The commenters agree both that the bundling restrictions can be removed "if the markets for components of the commodity bundle are workably competitive" (*see* FNPRM at ¶ 3 (quoting *Computer II*, 77 F.C.C.2d at 443 n.52)), and that the interexchange, CPE, and enhanced services markets are all fully competitive. For example, many commenters acknowledge that "competition in the domestic interexchange market has evolved to the point where no carrier is able to exercise market power in the provision of long distance services." *See, e.g.,* Sprint at 3; ISP/C at 6; CompTel at 3, 5; MCI WorldCom at 7; API at 8-9. Because the interexchange market is competitive, bundling poses no threat to competition, because, as Sprint puts it (at 4), "[a] carrier without market power can no more force a customer into purchasing unwanted products or services than Giant can force customers to shop at its stores rather than Safeway."<sup>3</sup> And virtually all commenters recognize what the Commission has long held: that the markets for CPE and enhanced

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<sup>3</sup> *See also* MCI WorldCom at 7 ("[w]hatever pricing advantage an IXC could offer by selling service and CPE at a bundled discounted price would have to be cost-related -- and therefore not harmful to competition -- or the IXC could not profitably offer such a bundled discount in the long run") and 30-31 (only leverage IXC could bring to bear would be whatever leverage could be derived from the superior value and quality of its services, considered separately).

services are intensely competitive. *See, e.g.,* BellSouth at 3-4; API at 8-9; Ameritech at 7; Bell Atlantic at 7-10; CompTel at 3.

Moreover, a broad array of commenters recognize the potential benefits of permitting the bundling of interexchange services with CPE and enhanced services. As one customer group states, "[f]rom the perspective of corporate users, elimination of the bundling restrictions is one of the preeminent deregulatory initiatives the Commission could undertake." API at 3; *see also* ENTUA at 3. Bundling would permit carriers to pass on savings from joint marketing and to price more efficiently. *See, e.g.,* MCI WorldCom at 9 (existing "rule still prevents IXC's from passing along the cost savings resulting from joint marketing and sales of services and CPE"); KMC at 4 (bundling would permit "carriers to offer consumers reduced prices that reflect savings in transaction costs"); GTE at 5. Other commenters point out that bundling could promote innovation by allowing one company to shift risk to another company through marketing agreements. *See, e.g.,* GTE at 5; BellSouth at 11-12; Ameritech at 17.

In addition, a number of commenters recognize that bundling of interexchange services and CPE would have no effect on non-dominant carriers' network disclosure obligations under the "all-carrier rule" (47 C.F.R. § 64.702(d)(2)). *See, e.g.,* MCI WorldCom at 40; U S WEST at 5-7. Offering interexchange services and CPE together at a bundled price does not in any way preclude a carrier from fulfilling its disclosure obligations, and in all events carriers have every incentive to disclose their interfaces in order to maximize the extent to which others can interconnect with their networks. However, as AT&T explained in its Comments (at 13-14), the Commission should no longer require carriers to disclose *all* information relating to network design. Carriers



should be permitted to have proprietary interfaces so long as any party has access to a disclosed network interface that provides the same features and functionalities. Such a rule would not disadvantage anyone, but at the same time it would promote competition by allowing carriers to offer services they could not otherwise offer (because of concerns about unauthorized access to their network). In that regard, the concerns of some commenters that the Commission should not permit any proprietary interfaces under any circumstances are unfounded.

The comments also confirm that an "unbundled option" rule (*i.e.*, a rule requiring carriers that offer bundles also to offer each piece of the bundle separately) is unnecessary. *See* MCI WorldCom at 36-39; CompTel at 7. "[T]he intense competition that characterizes the interexchange and enhanced service and CPE markets ensures that consumers will have choices of bundled and unbundled services and products at competitive prices" without such a rule.<sup>4</sup> MCI WorldCom at 37. In a competitive market, carriers will almost certainly offer their telecommunications services on a stand-alone basis regardless of whether the Commission adopts such a rule, and therefore the Commission need not adopt such unnecessary regulation.

Finally, as AT&T urged (at 15), the Commission should not decide now whether the Bell Operating Companies ("BOCs") should be allowed to bundle interLATA interexchange services

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<sup>4</sup> For this reason, Ameritech's assertion that AT&T could use its "presence" in the interexchange market to increase its market share in Internet access services is ludicrous. *See* Ameritech at 18-19. The Commission has found that AT&T has no unilateral market power in the interexchange market, and therefore AT&T has no market power to leverage into the Internet access market.

offered through their Section 272 affiliates with CPE or enhanced services. As MCI WorldCom demonstrates in detail (at 12-23), the BOCs' ability to offer such bundles would raise a number of serious concerns about the potential for anticompetitive behavior. The Commission should wait until it has practical experience with Section 271 relief to decide to what extent the current bundling restrictions should be lifted for the BOCs' interexchange services.

## **II. THE COMMISSION SHOULD NOT PERMIT THE DOMINANT INCUMBENT ILECS TO BUNDLE LOCAL SERVICES WITH CPE OR ENHANCED SERVICES.**

The commenters also agree -- with the exception of the ILECs -- that the Commission should not permit dominant ILECs to bundle either CPE or interstate enhanced services with local services.<sup>5</sup> All of the concerns that underlay the original *Computer II* restrictions still apply with full force to the dominant ILECs, because of their enormous market power in local exchange services. Indeed, even the three commenters that nominally support retention of the bundling restrictions focus all of their arguments on the potential anticompetitive impact of permitting the *ILECs* to engage in such bundling. *See* AOL at 7-11; CEMA at 3 (removing no-bundling rule for dominant carriers would be antithetical to competition); Team Centrex at 3-4.

As the commenters recognize, the ILECs have overwhelming market power in the local telephone market, and therefore permitting them to bundle local services with either CPE or

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<sup>5</sup> *See* FNPRM, ¶¶ 27, 40; MCI WorldCom at 14-15, 23-24; CEMA at 3; CIX at 2-3; CompTel at 8; ISP/C at 6 (relax restrictions for ILECs only when they have lost their facilities monopoly); KMC at 3.

enhanced services would allow them to leverage that market power into these other markets. With respect to the bundling of CPE, because the vast majority of consumers have no alternative to the ILEC, the Commission's original concern in *Computer II* -- that permitting bundling of local services with CPE would allow the ILECs to effectively force customers to take the ILEC's CPE -- is still valid. MCI WorldCom at 15 (citing *Computer II*, 77 F.C.C.2d at 443 n.52). Moreover, the ILECs could harm competition in the CPE market through cross-subsidies from its monopoly local service revenues (see *Computer II*, 77 F.C.C.2d at 443 n.52). As MCI WorldCom recognizes, retention of the bundling restriction is especially important today, because the ILECs could also harm emerging competition in the local service market through anticompetitively priced bundles. MCI WorldCom at 15-16.

Similarly, a number of enhanced service providers note that the threat to competition is even more serious in the case of bundling local services with enhanced services. *E.g.*, CIX at 6 ("bundling would have especially pernicious impact on the Internet market"). As MCI WorldCom points out (at 31), the potential for cost misallocation is much greater because of the extensive operational overlap between local services and enhanced services. See also KMC at 5 (bundling of local and enhanced services would make it impossible to detect cross-subsidization); ISP/C at 7 (same). The ISP commenters make clear that the "ILECs' existing monopoly access to the nation's end-users provide them with both motive and incentive to leverage and expand that monopoly into adjacent markets, including the Internet access market, which rely on access to the ILEC network as an essential input of service in those adjacent markets." CIX at 2-3. Not only would such bundling harm competition in the enhanced services market, but (as with bundling of CPE) the ILECs could

also use such bundling to harm the still-developing competition for bundled interstate and local services. MCI WorldCom at 31-32. The more goods and services the ILECs are allowed to bundle with local services, the more difficult it will be to detect cross-subsidization.<sup>6</sup>

Indeed, several commenters provide evidence that the ILECs may already be using bundling to leverage their market power in local services into these other markets. CIX provides examples of ILEC advertising in which the ILECs are already offering package discounts for local service bundled with Internet access services and CPE (such as modems). *See* CIX at 8-9. Other commenters offer similar evidence. *See, e.g.,* America Online at 8 n.16, 10 (ILECs have offered free Internet access with the purchase of a second line, and noting other concerns about anticompetitive conduct and discrimination); Team Centrex at 3-4 (subsidization of Centrex CPE with Centrex revenues); Network Plus at 5-6 (Bell Atlantic tying of local services and voice messaging services harming local competition); ISP/C at 7 ("[m]any ISPs can provide detailed accounts of RBOC and GTE behavior that an impartial observer would have to describe as intentional discrimination"). As these examples suggest, allowing dominant LECs to include local service in bundles with CPE or interstate enhanced services would greatly increase the potential for anticompetitive behavior, and therefore the Commission should not permit it.

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<sup>6</sup> MCI WorldCom at 31-32 ("The problem of cross-subsidization, aggravated by the difficulty of overseeing the ILECs' imputation of access costs where CPE is offered as part of a bundle of ILEC long distance and local services, would be magnified if enhanced services could also be added to such bundles. The more complex the ILEC affiliate bundle, the more likely it is that a failure to impute by the ILEC affiliate would go undetected").

Against this reasoning, the ILECs make three basic arguments, all of which are meritless. First, some ILECs erroneously claim that the local market is already competitive. The Commission has made numerous findings in recent months that competition in the local exchange market is minuscule. For example, the Commission recently noted that "incumbent LECs are still the sole actual providers of local exchange and exchange access services to the vast majority of mass market customers in most areas of the United States."<sup>7</sup> Moreover, "[i]ncumbent LECs continue to dominate the market for local exchange and exchange access services to [large] business customers." *MCI WorldCom Merger Order*, ¶ 172; *AT&T-TCG Merger Order*, ¶ 26.<sup>8</sup> The ILECs have failed to

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<sup>7</sup> *Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, CC Docket No. 97-211, Memorandum Opinion and Order, ¶ 169 (rel. September 14, 1998) ("*MCI WorldCom Merger Order*"); see also *Applications of Teleport Communications Group, Inc., Transferor, and AT&T Corp., Transferee, For Consent to Transfer Control of Corporations Holding Point-to-Point Microwave Licenses and Authorizations to Provide International Facilities-Based and Resold Communications Services*, CC Docket No. 98-24, Memorandum Opinion and Order, ¶ 24 (rel. July 23, 1998) ("*AT&T-TCG Merger Order*") (same).

<sup>8</sup> Indeed, the Commission has specifically noted that "[c]ompetition is still in its infancy in the vast majority of local areas," and that the evidence shows that "even in the market for business customers in the New York metropolitan area . . . the incumbent LEC has lost only six percent of the market to competitors." *MCI WorldCom Merger Order*, ¶ 168 (citing New York Public Service Commission analysis). See also *Prescribing the Authorized Unitary Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Notice Initiating a Prescription Proceeding and Notice of Proposed Rulemaking, FCC 98-222, ¶ 20 ("The RBOCs and rate-of-return ILECs both provide interstate services, [but] their primary business is still the provision of [local] telephone service and neither is subject to any meaningful competition for regulated telecommunications services in their service area").

provide any evidence that competition in the local telephone market has advanced to the point where the dominant LECs no longer have vast market power.

Second, the ILECs are also incorrect in claiming that it is irrelevant whether or not there is competition in the local market. *See* FNPRM, ¶ 3 (noting prior Commission finding that the market for *each* of the components in a commodity bundle must be competitive to remove concerns about bundling). The ILECs' claim is based entirely on their misinterpretation of the Commission's *Cellular Bundling Order*.<sup>9</sup> *See* BellSouth at 5-8; SBC at 3-4, 6; Ameritech at 4-6; Bell Atlantic at 3-4. Contrary to these ILECs' assertions, the *Cellular Bundling Order* does not stand for the blanket proposition that a carrier with market power in one market can bundle those services with another good or service as long as the second market is competitive. Rather, the Commission's decision in that order to permit carriers to bundle cellular service with cellular CPE was based on certain findings about the unique characteristics of the cellular market. In particular, although the Commission did not have sufficient evidence in the record to conclude that the cellular market was "fully competitive," it did find that the "facilities-based carriers are competing on the basis of market share, technology, service offerings, and service price."<sup>10</sup> Moreover, the Commission found that the public interest benefits of bundling cellular CPE outweighed the possible harms, because the cellular service market

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<sup>9</sup> *Bundling of Cellular Customer Premises Equipment and Cellular Service*, 7 FCC Rcd. 4028 (1992) ("*Cellular Bundling Order*").

<sup>10</sup> *Cellular Bundling Order*, 7 FCC Rcd. at 4029 (¶ 11); *see id.* at 4030 (¶ 13) ("because most cellular markets are duopolistic rather than monopolistic, a carrier's market power is attenuated").

was still developing and the "record supports a finding that the high price of CPE represents the greatest barrier to inducing subscription to cellular service."<sup>11</sup>

Those unique circumstances do not remotely apply to the dominant wireline ILECs. Unlike the duopolistic cellular carriers of 1992, the wireline ILECs remain the *only* option available to the vast majority of consumers today, and therefore the ILECs' market power is exponentially greater. Moreover, the local service market is not in the early stages of development, as was the cellular market, and therefore any suggestion that dominant ILECs need to be able to bundle local service and CPE (or enhanced services) in order to attract local service customers is misplaced. The manifest public interest harms of permitting dominant LECs to bundle local service with CPE or enhanced services easily outweigh any imagined benefits, and the ILECs have offered no reason to think otherwise.

Indeed, the pertinent precedent is not the *Cellular Bundling Order*, but *Computer II* itself. There, the Commission prohibited the bundling of dominant wireline services with CPE, even though the Commission acknowledged that the CPE market was competitive. *See Computer II*, 77 F.C.C.2d at 443-47. With respect to the dominant LECs' local exchange services, the premises of the Commission's *Computer II* rules are just as true today as they were in 1980. *See MCI WorldCom* at 14-15 ("The BOCs' and other ILECs' market dominance in local services thus remains about what it was when *Computer II* imposed the unbundling rules on all carriers; time has stood still for the

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<sup>11</sup> *Id.* at 4030-31 (¶¶ 19-20).

ILECs"). Therefore, the mere fact that the CPE and enhanced services markets are competitive would not justify allowing the ILECs to include them in a bundle with their monopoly local services.<sup>12</sup>

Finally, retaining the bundling restrictions for the dominant LECs would not place them at a competitive disadvantage, as the ILECs claim. *See, e.g.*, GTE at 16; Bell Atlantic at 14; Ameritech at 14. As Sprint notes (at 6), "the Commission has long subjected disparate classes of carriers to different regulatory treatment depending on market power," and rightly so. *See also* KMC at 5-6 (no unfairness because asymmetric regulation arises out of need to contain market power). Because of the dominant LECs' market power, they have a unique ability (as well as the incentive) to harm competition through bundling, and the Commission's rules should therefore treat the dominant and non-dominant LECs differently. *See* Sprint at 6 (irrational to require parity when each class of carrier differs in their ability to harm competition). As a number of commenters recognize, the Commission's longstanding distinction between dominant and non-dominant carriers has promoted, not frustrated, the development of competition despite the fact that it treats carriers differently. *See, e.g.*, MCI WorldCom at 26. The Commission should adhere to those distinctions

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<sup>12</sup> In this regard, the ILECs' assertions that a rule that required the ILECs to offer the constituent services on an unbundled basis would dispel any concerns about the abuse of market power are misplaced. *See* GTE at 12-13; BellSouth at 10; Ameritech at 5; Bell Atlantic at 4-6. Such a rule would do nothing to combat the ILECs' ability to engage in cost misallocation and other monopoly cross-subsidization to anticompetitively underprice competitors that seek to offer competing bundles. *See, e.g.*, MCI WorldCom at 15; Team Centrex at 3-4 (using Centrex revenues to underprice Centrex CPE, thus forcing CPE distributors to abandon the business).

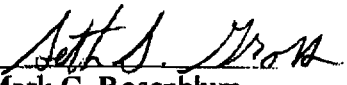


in this context, and should not permit the dominant LECs to bundle local services with CPE or interstate enhanced services.

### **CONCLUSION**

The Commission should immediately remove the restrictions on bundling telecommunications services with CPE and with enhanced services to the extent explained above and in AT&T's Comments.

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**CERTIFICATE OF SERVICE**

I, Rena Martens, do hereby certify that on this 23rd day of December, 1998, a copy of the foregoing "Reply Comments of AT&T Corp." was served by U.S. first class mail, postage prepaid, to the parties listed on the attached service list.

  
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